

No. 10,697

United States  
Circuit Court of Appeals  
For the Ninth Circuit

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AMELIA DAVIS BLOCH,

*Petitioner,*

vs.

COMMISSIONER OF INTERNAL REVENUE,

*Respondent.*

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PETITIONER'S OPENING BRIEF

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**PETITIONER'S OPENING BRIEF**

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I.

**STATEMENT OF JURISDICTION**

Petitioner, on August 21, 1942, filed her petition with The Tax Court of the United States (then known as the Board of Tax Appeals) for a redetermination of the deficiency determined against her by Respondent for the calendar year ended December 31, 1940, set forth in his notice of deficiency dated, and mailed to Petitioner on, May 26, 1942, and The Tax Court of the United States on October 5, 1943, entered its decision thereon adverse to Petitioner. Petitioner, on January 3, 1944, filed with the Tax Court her petition for the review of said decision by

the above entitled court. The Collection District in which Petitioner's return for said calendar year was filed is the First District of California. (Record,\* pp. 1, 2, 3, 4, 10, 52.)

The jurisdiction of the Tax Court of said petition is established by Section 272 of the Internal Revenue Code. The jurisdiction of this Court to hear this appeal is established by Sections 1141 and 1142 of the Internal Revenue Code.

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## II.

### STATEMENT OF CASE

The facts of this case have been stipulated by the parties by stipulation filed with the Tax Court on February 1, 1943. (Record, pp. 2, 18-40.) Petitioner, immediately prior to the statutory merger, hereinafter referred to, of Great Western Electro-Chemical Company, a California corporation (hereinafter called "Great Western") with and into The Dow Chemical Company, a Michigan corporation (hereinafter called "Dow") held 865 shares of the preferred stock, \$20 par value, and 280 shares of the common stock, without par value, of Great Western, represented as follows:

Certificates numbered P392-P398, inclusive, each representing 100 shares of preferred stock, \$20 par value;

Certificate numbered PL145 for 95 shares of preferred stock, \$20 par value;

Certificate numbered PL414 for 70 shares of preferred stock, \$20 par value;

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\*All references herein to the Record are to the Printed Record.



Certificates numbered 273 and 274 each representing 100 shares of common stock, no par value;

Certificates numbered L261 and L1178 representing respectively 30 and 50 shares of common stock, without par value.

(Record, p. 20.)

Petitioner acquired said stock at various times and at various prices. (Record, pp. 18-20.)

On or before December 31, 1938, Great Western merged with and into Dow under the terms and conditions of an Agreement of Statutory Merger between said corporations dated November 19, 1938 and pursuant to the applicable provisions of law of the State of California and of the State of Michigan. (Record, p. 21.)

The Agreement of Statutory Merger provides that on the effective date thereof the Great Western stock (excepting such stock as was held by either Great Western or Dow) should constitute and be converted into Dow stock on the following basis, viz.: Each share of preferred stock, \$20 par value, of Great Western into 3/16 of one full paid and non-assessable share of Dow common stock, without par value. Each share of common stock, without par value, of Great Western into one full paid and non-assessable share of Dow common stock, without par value. By virtue of Article III of said Agreement of Statutory Merger and the applicable provisions of law of the States of California and Michigan, on and after the effective date of said Agreement of Statutory Merger the aforementioned certificates represented the shares of Dow common stock, without par value, which said Great Western stock con-

stituted and into which they had been converted. (Record, pp. 28-29.)

Under date of January 24, 1939, Petitioner forwarded to the Cleveland Trust Company the above described certificates. The Cleveland Trust Company cancelled said certificates so forwarded by Petitioner and issued to Petitioner in lieu thereof the following numbered certificates of Dow respectively in lieu of the said certificates so forwarded by Petitioner:

<i>Dow Certificates Issued</i>	<i>Dow Common Shares Represented Thereby</i>	<i>Great Western Certificates Cancelled</i>
C5822	100 shares )	( P392-398
C18244	62 shares )	( PL145
CLF171	3/16ths )	( PL414
C5823	100 shares	273
C5824	100 shares	274
C018245	50 shares )	( L261
	)	( L1178

(Record, p. 22.)

In March 1940 Petitioner sold 212 shares of Dow common stock for a total selling price of \$33,264.24, 100 of which said 212 shares were represented by said Dow certificate numbered C5822, 62 of said 212 shares were represented by said Dow certificate numbered C018244, and 50 of said 212 shares were represented by said Dow certificate numbered C018245, acquired as aforesaid. (Record, p. 22.)

The question involved herein is as to the proper method for the determination of the basis of the Dow common stock to be used for determining the amount of gain or

loss realized on said sale. It is conceded by the parties, and was held by the Tax Court (Record, p. 48) that said shares of Dow common stock were acquired by Petitioner on a "tax-free" exchange or "reorganization" (of Great Western and Dow) as defined in Section 112(g)(1) of the Internal Revenue Code\* and that the basis of said shares is governed by Section 113(a)(6) of the Internal Revenue Code. Petitioner claims that under Section 113(a)(6) the basis of the shares of Dow common stock sold is the same as the basis to her of the identical shares of Great Western stock, which said shares of Dow common stock constituted and from which they were converted—i.e., for which they were received in exchange—on the statutory merger of the Great Western with and into Dow. The Commissioner claims that while there is identification between the Great Western certificates surrendered and the Dow certificates received on the exchange, nevertheless Petitioner is not entitled to so trace the basis of the Dow stock to, and to identify it with, the basis of the Great Western stock but that under Section 113(a)(6) said basis in this case is to be determined by dividing the total cost of all shares of Great Western stock held by Petitioner at the time of the statutory merger by the number of shares of Dow common stock received on the exchange.

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\*The instant transactions commenced prior to December 31, 1938. However, the applicable provisions of the Internal Revenue Code are identical with the corresponding provisions of the Revenue Act of 1938.

## III.

## SPECIFICATION OF ERRORS

*A.* The Tax Court erred in holding that the basis to Petitioner of said 212 shares of Dow common stock sold by her in March 1940 is to be determined by dividing the total cost to Petitioner of the shares of Great Western stock acquired by her at different times and at different prices by the total number of shares of Dow common stock received by her and in not holding that the basis of said 212 shares of Dow common stock is the same as the basis to Petitioner of the identical shares of Great Western stock which said shares of Dow common stock constituted and from which they were converted—i.e., for which they were exchanged on the statutory merger of Great Western with and into Dow.

*B.* The Tax Court erred in holding that the basis to Petitioner of the Dow common stock acquired by her on the statutory merger of Great Western with and into Dow was to be determined by dividing the total cost of the Great Western stock held by her by the number of shares of Dow common stock acquired on the merger.

*C.* The Tax Court erred in failing to hold that under Section 113(a)(6) of the Internal Revenue Code the basis of the Dow stock acquired on the statutory merger of Great Western with and into Dow is the same as the basis of the Great Western stock which it constituted and from which it was converted on the said statutory merger.

*D.* The Tax Court erred in holding that notwithstanding the identification between the Dow certificates received and the Great Western certificates surrendered in the

exchange that the basis of the Dow stock sold was to be determined by dividing the total cost of Great Western stock surrendered by the number of shares of Dow stock received.

*E.* The Tax Court erred in failing to hold that under Section 113(a)(6) of the Internal Revenue Code in view of the identification between the Great Western certificates surrendered and the Dow certificates received that the basis of the Dow stock sold was the same as the identical stock for which it was exchanged.

*F.* If the opinion of the Tax Court can be construed as finding that in 1939, and not in 1938, Petitioner received the shares of Dow common stock in question in exchange for shares of Great Western stock held by her, then such finding is erroneous and in conflict with the stipulation of the parties. The Great Western stock was constituted and converted into—i.e., exchanged for—Dow common stock on the effective date of the statutory merger of Great Western with and into Dow and said statutory merger took place on or before December 31, 1938. (Record, pp. 21, 28.) In 1939 there was merely an exchange of certificates each representing Dow common stock. (Record, p. 22.)

## IV.

**SUMMARY OF ARGUMENT**

Petitioner in support of her position relies on the following points:

A. For convenience, the instant transaction may be regarded as comprising two exchanges, viz.: First, the constitution and conversion, pursuant to law, of Great Western stock—i.e., exchange for—Dow stock, on the effective date of the Statutory Merger which occurred on or prior to December 31, 1938; and, second, the 1939 Certificate Exchange. It is the basis of the Dow stock acquired on the First Exchange which is governed by Section 113(a)(6) of the Internal Revenue Code.

B. On the First Exchange, pursuant to law, each share of Great Western stock was constituted and converted—i.e., exchanged for—a share or fractional share of Dow common stock. Each Great Western share is identical, by operation of law, with the share or fractional Dow share which it constituted and into which it was converted on the Merger. Accordingly, for each of these reasons under Section 113(a)(6) of the Internal Revenue Code, the basis of each share or fractional share of Dow common stock so acquired is the same as the identical share of Great Western stock which it constituted and from which it was converted on the First Exchange.

C. On the Second Exchange there was identification between the certificates surrendered and the certificates received and accordingly the basis of the certificates received and the stock represented thereby may be identified with and traced to the certificates surrendered and stock represented thereby.

D. The rule that on a "tax-free" exchange the basis of the stock acquired is determined by dividing the total cost of the stock surrendered by the number of shares acquired is inapplicable where there is identification between the certificates sold. In the instant case there was identification between the certificates acquired and the certificates surrendered.

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V.

**ARGUMENT**

**A. Governing Statutory Provisions and Regulations.**

As above set forth, it is conceded by the parties, and was held by the Tax Court, that the Dow common stock sold by Petitioner was acquired by her for Great Western stock on a so-called "tax-free" exchange and on a "reorganization" (of Great Western and Dow) as defined in Section 112(g)(1) of the Internal Revenue Code and the basis of the Dow common stock sold is governed by Section 113(a)(6) of the Internal Revenue Code providing generally for the basis of property acquired on a "tax-free" exchange. (Record, p. 48.)

Section 112(g)(1) defines the term "reorganization" and clause (A) of the definition includes a "statutory merger." Section 112(b)(3) of the Internal Revenue Code provides that the exchange of stock on a "reorganization" shall be "tax-free." Section 113(a)(6) prescribes generally the basis of property acquired on such a "tax-free" exchange.

Section 112(g)(1) provides:

"Section 112(g). Definition of Reorganization. As used in this Section . . . and in Section 113 . . . —

- (1) The term 'reorganization' means (A) a statutory merger or consolidation . . ."

Section 112(b)(3) provides:

"Section 112(b)(3). Stock for Stock on Reorganization. No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization."

Section 113(a)(6) provides:

"Sec. 113. Adjusted Basis for Determining Gain or Loss.

(a) Basis (Unadjusted) of Property.—The basis of property shall be the cost of such property; except that—

\* \* \* \* \*

(6) Tax-free exchanges generally.—If the property was acquired, after February 28, 1913, upon an exchange described in Section 112(b) to (e), inclusive, the basis (except as provided in paragraphs (15), (17), or (18), of this subsection) *shall be the same as in the case of the property exchanged*, decreased in the amount of any money received by the taxpayer and increased in the amount of gain or decreased in the amount of loss to the taxpayer that was recognized upon such exchange under the law applicable to the year in which the exchange was made. \* \* \*'' (Italics supplied.)

Under the Regulations:\*

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\*The provisions here quoted from Regulations 111 are identical with the corresponding provisions of Regulations 101 and 103 which were in effect when the instant transactions occurred.



(i) Great Western is, and Dow is, a “party to the reorganization” of Great Western and Dow within the meaning of Section 112(b)(3). (Regulations 111, Sec. 29.112(g)-2.) The regulation provides “Both corporations are parties to the reorganization if under statutory authority corporation A is merged into corporation B; . . .”

(ii) The “plan of reorganization” referred to in Section 112(b)(3) as applied to the instant case is the “statutory merger” of Great Western and Dow. See Regulations 111, Sec. 29.112(g)-2 which states that the “term ‘plan of reorganization’ refers to the consummated transaction specifically defined as a reorganization under Section 112(g)(1)” —i.e., in this case the “statutory merger” of Great Western and Dow.

Accordingly under Section 112(b)(3) the “exchange of Great Western stock for Dow common stock on the “statutory merger” of Great Western is “tax-free” and the basis of the Dow common stock acquired on this exchange is governed by Section 113(a)(6).

**B. For Convenience, the Instant Transaction May Be Regarded as Comprising Two Exchanges, viz.: First, the Constitution and Conversion, Pursuant to Law, of Great Western Stock—i.e. Exchange for—Dow Stock, on the Effective Date of the Statutory Merger Which Occurred on or Prior to December 31, 1938; and, Second, the 1939 Certificate Exchange. It Is the Basis of the Dow Stock Acquired on the First Exchange Which Is Governed by Section 113(a)(6) of the Internal Revenue Code.**

For convenience, the instant transaction may be regarded as comprising two exchanges, viz:

*First Exchange.* On the effective date of the statutory merger of Great Western with and into Dow (which according to the stipulation of the parties occurred on or

prior to December 31, 1938) the Great Western stock held by Petitioner immediately prior thereto constituted and was converted into Dow common stock pursuant to the provisions of said Agreement of Statutory Merger and the applicable provisions of law of the States of California and Michigan.

As above pointed out, Article III of the Agreement of Statutory Merger provides that on the effective date of the statutory merger each share of Great Western preferred stock should constitute and be converted into 3/16 of one share of Dow common stock and each share of Great Western common stock should constitute and be converted into one share of Dow common stock. The inclusion of this provision for conversion in the Agreement of Statutory Merger was required by the laws of the States of California and Michigan. See

*California Civil Code*, Sections 361, 361a;

*Michigan General Corporation Act*, Section 52.

Pursuant to this provision of the Agreement of Statutory Merger and in accordance with said provisions of law, on the effective date of said Agreement (which occurred on or prior to December 31, 1938) the Great Western stock in accordance with the terms of said Agreement constituted and was converted into—i.e., exchanged for—Dow common stock and on and after said effective date the Great Western stockholders became and were common stockholders and the Great Western certificates represented Dow common stock.

*Copland v. Minong Mining Co.* (1875), 33 Mich. 2;

*Ridgway v. Griswold* (1878) (C.C.D. Kansas), 20

Fed. Cases, Case No. 11,819.

See, also, *National Supply Co. v. Leland Stanford Junior University* (C.C.A. 9th Cir., 1943), 134 Fed.(2d) 689, certiorari denied, 1943, 320 U.S. 773, in which this Court held that shares acquired on a statutory consolidation did not involve the sale of securities under the Securities Act of 1933.

*Second Exchange.* In January 1939 Petitioner exchanged Great Western certificates which then represented Dow common stock for Dow certificates likewise representing Dow common stock.

This Second Exchange was a mere exchange of pieces of paper without any real legal significance. Even without the exchange of the physical certificates the old Great Western certificates automatically, from and after the effective date of the merger, represented and would have continued to represent Dow common stock. It is only the First Exchange that has any true legal significance. It is an essential characteristic of a statutory merger that immediately and automatically, by operation of law—or by legal fiction—the old Great Western shares were, at the moment the merger became effective, transmuted or transmogrified into Dow common stock, and this regardless of any exchange of physical certificates. It is immaterial whether the Second Exchange or “paper exchange” of the certificates occurs at or near the First Exchange or even years thereafter, since, from the moment of the effective date of the merger, the old Great Western certificates thereafter represented Dow common stock. The Second Exchange is required only for practical purposes and as a matter of record.

It is clear, therefore, as is set forth in the Specifications of Error that if the opinion of the Tax Court can be construed as finding that in 1939 and not in 1938 Petitioner received the Dow common stock in exchange for Great Western stock held by her then such finding is erroneous and in conflict with the stipulation of the parties.\*

It is the First Exchange, and not the Second Exchange, which is the "tax-free" exchange to which Section 112(b) (3) of the Internal Revenue Code is applicable, and it is the Dow common stock acquired on the First Exchange and not the Dow certificates acquired on the Second Exchange which is the property the basis of which is prescribed by said Section 113(a)(6) of the Internal Revenue Code. It is the First Exchange which took place on the effective date, and was a part of the "statutory merger" (i.e., "reorganization") of Great Western and Dow. As above stated, under Section 112(b)(3) the exchange, on the "statutory merger," of Great Western stock for Dow stock is made "tax-free" and Section 113(a)(6) governs the basis of the stock acquired on this "tax-free" exchange. The Second Exchange was merely an exchange of certificates each then representing the same kind of stock, viz: Dow common stock.

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\*The objectionable language in the opinion of the Tax Court is as follows: "There is no question but that the Dow shares were received by the petitioners in 1939 upon a reorganization under Section 112(g)(1) I.R.C." (Record, p. 48.) It is not clear whether by this statement the Tax Court intended to find that the Dow shares were received by Petitioner in 1939 or whether 1939 was merely referred to, in passing, as the year in which petitioner acquired the Dow certificates.

C. On the First Exchange, Pursuant to Law, Each Share of Great Western Stock Was Constituted and Converted—i.e., Exchanged for—a Share or Fractional Share of Dow Common Stock. Each Great Western Share Is Identical, By Operation of Law, With the Share or Fractional Dow Share Which It Constituted and Into Which It Was Converted on the Merger. Accordingly For Each of these Reasons Under Section 113(a)(6) of the Internal Revenue Code, the Basis of Each Share or Fractional Share of Dow Common Stock so Acquired Is the Same as the Identical Share of Great Western Stock Which It Constituted and From Which It Was Converted on the First Exchange.

Section 113(a)(6) of the Internal Revenue Code provides that the basis of the property acquired on the exchange “*shall be the same as in the case of the property exchanged.*” In the instant transaction under the provisions of the Agreement of Statutory Merger and the applicable laws of the States of California and Michigan, on the First Exchange *each* share of Great Western preferred stock was constituted and converted into—i.e., exchanged for— $\frac{3}{16}$  of one share of Dow common stock and *each* share of Great Western common stock was constituted and converted into—i.e., exchanged for—one share of Dow common stock.

In other words, by virtue of the provisions of the Agreement of Statutory Merger and the applicable provisions of law of the States of California and Michigan, there was a separate and distinct exchange of each share of Great Western stock for the share or fractional share of Dow common stock which it constituted and into which it was converted on the First Exchange. (See *supra*, pp. 12-13 for cases holding that on the effective date of the statutory merger the shares of a merging corporation constituted

and are converted into shares of the surviving corporation.) Furthermore, the Great Western stock represented by each Great Western certificate immediately prior to the First Exchange was constituted and converted—i.e., exchanged for—the Dow common stock represented by such certificate on and after the First Exchange. This Court and the Court below in applying Section 113(a)(6) of the Internal Revenue Code are bound by local law as to matters of this kind and accordingly must treat each such separate constitution and conversion as a separate exchange.

*Burnet v. Harmel* (1932), 287 U.S. 103;

*Bankers Pocahontas Coal Co. v. Burnet* (1932), 287 U.S. 308;

*Burk-Waggoner Oil Association v. Hopkins* (1925), 269 U.S. 110;

*Helvering v. Metropolitan Edison Company* (1939) 306 U.S. 522;

*U. S. v. Seattle-First National Bank* (1944) 88 L.Ed. (Adv. Op.) 593, 64 Sup.Ct. 713.

See, also, *National Supply Co. v. Leland Stanford Junior University*, *supra*.

Under Section 113(a)(6) the basis of the property acquired on the exchange is “*the same as in case of the property exchanged*”. Therefore, under Section 113(a)(6) the basis of each share and fractional share of Dow common stock thus acquired is the same as the identical share of Great Western stock which it constituted and from which it was converted (i.e., for which it was received in exchange) on the First Exchange and the basis of the Dow

common stock represented by each Great Western certificate on and after the First Exchange is the same as the Great Western stock represented by said certificate immediately prior to the First Exchange.

Cf. *Fuller v. Commissioner* (C.C.A. 1st, 1936) 81 F.(2) 176.

The application of any other rule in this case would lead to the strange and unusual result that the basis of each Great Western certificate held by Petitioner was, on the effective date of the merger, changed from its original basis to some other basis. Certainly the Court should not reach any such conclusion in the absence of strong and persuasive language compelling it so to do. Cf. *Helvering v. Rankin* (1935), 295 U.S. 123, 129, et seq.

The Tax Court held that the basis of the Dow common stock sold was to be determined by dividing the total cost of the Great Western stock by the number of shares of Dow stock received and in support of this ruling cited the following cases:

*Commissioner v. Oliver* (C.C.A. 3rd Cir., 1935), 78 Fed. (2d) 561;

*Helvering v. Stifel* (C.C.A. 4th Cir., 1935), 75 Fed. (2d) 583;

*Commissioner v. Von Gunten* (C.C.A. 6th Cir., 1935), 76 Fed.(2d) 670;

*Commissioner v. Bolender* (C.C.A. 7th Cir., 1936), 82 Fed.(2d) 591;

*Arrott v. Commissioner of Internal Revenue* (C.C.A. 3d—1943), 136 Fed.(2d) 449;

*Raul H. Fleischmann v. Commissioner* (1939), 40 B.T.A. 672.

These cases arose under Section 113(a)(6) of the Internal Revenue Code (or its corresponding section in the prior Revenue Acts) and involved "tax-free" exchanges, under Section 112(b)(3), of the stock of one corporation for the stock of another corporation in connection with the acquisition by the second named corporation of the assets of the first named corporation in a "reorganization" as defined by Section 112(g)(1). These cases did not involve a statutory merger of one corporation with and into the other but a simple transfer of assets by one corporation to the other. In these cases it was held that the basis of each share of stock acquired was to be determined by dividing the aggregate cost of the stock surrendered by the number of shares acquired. Conceding solely for the purpose of argument under this point, that the rule of these cases is applicable where there has been identification on a voluntary exchange of certificates (with which position we will take issue under point E below) such rule is not applicable in the case of a statutory merger for the reasons above stated, viz:—On a statutory merger there is a separate and direct exchange, pursuant to law, of each share of the merging corporation for the share or fractional share of the surviving corporation which it constituted and into which it was converted on the merger. The Federal Court in applying Section 113(a)(6) must give effect to this provision of law and accordingly hold that the basis of each such share or fractional share of the surviving corporation (in this case—Dow) is the same as the basis of the individual share of the merging corporation (in this case—Great Western) which it constituted and from which it was converted on the effective date of the merger.



Furthermore, in view of the identity arising by operation of law, between each Great Western share and the share or fractional share of Dow which it constituted and into which it was converted on the merger, the rule of the cases relied on by the Tax Court is inapplicable and the instant case comes instead within the rule applicable to a "recapitalization" under which "identification" is permitted. It is well established that the rule of the cases relied on by the Tax Court do not apply to stock acquired on a "recapitalization" of a corporation.

*Kraus v. Commissioner* (C.C.A. 2d—1937), 88 Fed. (2d) 616;

*Fuller v. Commissioner* (C.C.A. 1st—1936), 81 Fed. (2d) 176.

In the *Kraus* and *Fuller* cases there was a stock split-up. In both the *Kraus* and *Fuller* cases, there was a "reorganization" under Section 112(g)(1), the exchange on the split-up was a "tax-free" exchange under Section 112(b)(3), and the basis of the stock acquired on the split-up was governed by Section 113(a)(6).

In the *Kraus* case, the "first-in first-out" rule was applied because there was no identification of the stock sold. In the *Fuller* case identification of the stock sold was proved and identification was allowed. In both cases, the Court refused to apply the rule applied by the Tax Court in this case, viz: that the basis of the stock acquired on a "tax-free" exchange is determined by dividing the total cost of the stock exchanged by the number of shares received, but held that in such cases the general rules for determining basis of stock on an exchange (i.e., the "first-in first-out" rule and the "identifica-

tion" rule) were applicable. The basis of the rule of the *Kraus* and *Fuller* cases is the *identity* of the shares acquired on the "recapitalization" or split-up with the original shares which had been split up.

*Kraus v. Commissioner*, supra, 88 Fed.(2d) 616,  
at 618;

*Fuller v. Commissioner*, supra, 81 Fed.(2d) 176,  
at 178.

It is clear that the instant case comes within the rule laid down by the *Kraus* and *Fuller* cases. As above stated, there is a direct identity between the Great Western stock held by Petitioner immediately prior to the First Exchange and the Dow common stock acquired by her on the First Exchange. Pursuant to the Agreement of Statutory Merger and the applicable laws of the States of California and Michigan, each share of Great Western stock was constituted and converted a share or fraction of share of Dow common stock.

In the *Kraus* and *Fuller* cases and in the instant case this identity between the shares of Great Western (the merging corporation) and the shares of Dow (the surviving corporation) is established by operation of law. Cf. *U. S. v. Seattle-First National Bank* (1944), 320 U.S. 723, holding that on a statutory consolidation a transfer of stock was by operation of law and a transfer of real property was effectuated by virtue of the statute prescribing for consolidations.

See also:

*Copland v. Minong Mining Co.*, supra;  
*Ridgway v. Griswold*, supra.

There is certainly just as much identity between the shares of the merging corporation and the shares of the surviving corporation on a statutory merger as there is between the original shares and the new shares on a stock split-up.

Furthermore, by virtue of the laws of the States of California and Michigan the corporate identity of Great Western was "merged into" the corporate identity of Dow.

*California Civil Code*, Sections 361, 361a;

*Michigan General Corporation Act*, Sec. 53.

The courts, in tax and other kindred cases, have given effect to this continuance of corporate identity on a statutory merger and consolidation.

In the case of *Helvering v. Metropolitan Edison Company* (1939), 306 U.S. 522, which arose under the income tax law, the United States Supreme Court held that the surviving corporation on a statutory merger or consolidation is entitled to use the unamortized bond discount of a merging or consolidating corporation but that the corporation which merely acquired the assets of another corporation is not entitled to use such amortized bond discount of the transferee corporation.

In *U. S. v. Seattle-First National Bank*, supra, which arose under the Stamp Tax law, the United States Supreme Court held that in a statutory consolidation the consolidated corporation acquired the assets of a consolidating corporation by virtue of the provisions of law and that such acquisition was effectuated without the necessity of any deed, instrument or writing.

In *National Supply Co. v. Leland Stanford Junior University*, supra, this Court held that the issuance of stock

on a statutory merger or consolidation was not a sale under the Securities Act of 1933.

In view of this identity between the shares of Dow common stock held by Petitioner on and after the First Exchange and the Great Western stock held by her immediately prior to the First Exchange and the corporate identity between Great Western and Dow, it is clear that the rule laid down by the *Kraus* and *Fuller* cases is applicable in the instant case and that accordingly the basis of the Dow stock acquired is the same as the basis of the Great Western stock from which it was converted on the First Exchange.

We have shown that:

(i) On the First Exchange there was a separate exchange, pursuant to law, of each share of Great Western stock for the share or fractional share of Dow stock which it constituted and into which it was converted on the merger.

(ii) There is identity by operation of law between each share of Great Western stock and the share or fractional share of Dow stock which it constituted and into which it was converted on the merger. By operation of law the corporate identity of Great Western has been merged into the corporate identity of Dow. The rule of the *Kraus* and *Fuller* cases is therefore applicable.

Therefore under Section 113(a)(6) of the Internal Revenue Code for each of these reasons the basis of the Dow share sold is the same as the basis of the identical Great Western shares which they constituted and from which they were converted on the statutory merger.

D. On the Second Exchange There Was Identification Between the Certificates Surrendered and the Certificates Received and Accordingly the Basis of the Certificates Received and the Stock Represented Thereby May Be Identified With and Traced to the Certificates Surrendered and Stock Represented Thereby.

As above set forth, at the time of the Second Exchange the Great Western certificates surrendered then represented Dow common stock. This exchange was just like any other exchange of certificates of stock of the same corporation. It has been stipulated between the parties that there is identification between the certificates surrendered and the certificates received on the Second Exchange. (Record, p. 22.)

It is clear, therefore, that under the decisions the basis of the certificates received on such exchange and the stock represented thereby may be identified with and traced to the basis of the certificates surrendered on said exchange and the stock represented thereby.

*Helvering v. Rankin*, supra;

*Davidson v. Commissioner* (1938), 305 U.S. 44;

*Fuller v. Commissioner*, supra.

In view of the foregoing, we have shown that on the First Exchange under Section 113(a)(6) the basis of the common stock acquired is the same as the identical Great Western stock from which it was converted on said Exchange. We have also shown that the basis of the Dow certificates acquired on the Second Exchange and the Dow common stock represented thereby may be traced to and identified with the basis of the Great Western certificates surrendered on said Exchange and the Dow common stock represented thereby. In this case, the taxpayer sold Dow

certificates acquired on the Second Exchange. Petitioner has thus established the requisite identity between the Dow stock sold and Great Western certificates and stock acquired by her and accordingly the basis of the said Dow common stock is the same as the basis of the Great Western stock from which it was converted.

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In our argument thus far we have conceded solely for the purposes of the argument that the rule that the basis of stock acquired on a "tax-free" exchange is determined by dividing the total cost of the stock surrendered by the number of shares acquired, is applicable in cases (such as the present one) where there is identification between the certificates surrendered and the certificates received on the exchange. Petitioner will now present, under point *E*, as an additional ground in support of her position that this general rule is not applicable in cases where, as here, there is identification between the certificates received and the certificates surrendered on a "tax-free" exchange. Accordingly, even though the arguments advanced under points *B* and *C*, above, be overruled by the Court, nevertheless, the Court must hold that the basis to Petitioner of the Dow common stock sold by her is the same as the basis to Petitioner of the identical Great Western stock for which they were exchanged.

E. The Rule That on a "Tax-Free" Exchange the Basis of the Stock Acquired Is Determined by Dividing the Total Cost of the Stock Surrendered by the Number of Shares Acquired Is Inapplicable Where There Is Identification Between the Certificates Sold. In the Instant Case There Was Identification Between the Certificates Acquired and the Certificates Surrendered.

With the exception of the case of *Rauol H. Fleischmann v. Commissioner* (1939), 40 B.T.A. 672, the cases cited by the Tax Court in its decision dealt with certificate exchanges on "tax-free" "reorganizations" where there was no identification between the certificates acquired and the certificates surrendered. It was held that under such circumstances the so-called "first-in first-out" rule now set forth in Regulations 111, Sec. 19.22(a)-8, was inapplicable. It was pointed out that under this Regulation the "first-in first-out" rule is applicable only to stock which is acquired at *different times* and that on a "tax-free" exchange the stock is acquired at the same time. It was accordingly held in these cases that under Section 113(a)(6), in the absence of identification, the basis of stock acquired on the exchange was determined by dividing the cost of the stock surrendered by the number of shares received.

*Commissioner v. Oliver*, supra, 78 Fed.(2d) 561,  
at 562;

*Helvering v. Stifel*, supra, 75 Fed.(2d) 583, at 584;  
*Commissioner v. Von Gunten*, supra, 76 Fed.(2d)  
670, at 671;

*Commissioner v. Bolender*, supra, 82 Fed.(2d) 591,  
at 592;

*Arrott v. Commissioner of Internal Revenue*, supra,  
136 Fed.(2d) 449, at 451.

Under such circumstances no other rule could have been applied. The only three possible bases are, (i) a basis determined by identification; (ii) a basis determined by some statutory or administrative rule such as "first-in first-out"; and (iii) a basis determined by averaging such as applied in these cases. Clearly, if there is no identification and no administrative or statutory rule is applicable, the only rule that can be applied is the "average cost rule" which was used.

In the *Fleischman* case, supra, the Board of Tax Appeals extended the rule of these cases to a situation where identification between the certificates surrendered and the certificates acquired on the exchange had been established. It is this extended rule which the Tax Court purported to apply in the instant case. It is respectfully submitted that the rule of the *Fleischmann* case cannot be supported. Section 113(a)(6) (which controls the *Fleischmann* case and controls the instant case) provides that the basis of the property acquired on the exchange "shall be the same as the basis of the property exchanged." If, as in the *Fleischmann* case and in the instant case, the taxpayer has shown that specific certificates surrendered were exchanged for specific certificates acquired, then under Section 113(a)(6) the basis of each such certificate thus acquired must be the same as the basis of the certificate for which it was surrendered. The "first-in first-out" rule and the "average cost rule" are arbitrary rules and these rules should be applied only in the absence of identification.

*Helvering v. Rankin* (1935), 295 U.S. 123.



In this case the Court held that identification of shares sold could be established by "intention" and that the "first-in first-out" regulation was inapplicable, which such intention had been shown and in answer to a claim that the "first-in first-out" regulation was invalid, said (p. 129 et seq.):

"The validity of the regulation, thus construed, cannot seriously be questioned. The contention advanced by the taxpayers, both here and in the companion case of *Snyder v. Commissioner of Internal Revenue*, 295 U.S. 134, 55 S.Ct. 737, that the regulation, as applied to marginal transactions, is invalid under the Fifth Amendment, because it creates a conclusive presumption, must rest wholly on the assumption that the shares traded on margin are incapable of identification. Since that assumption is erroneous, it is clear that no conclusive presumption is established. It is, at most, the burden of proof that is affected. For the margin trader, while being required to establish the identity of the shares, in order to avoid the 'First-in, first-out' rule, is left free to introduce any relevant evidence. *Nor is he arbitrarily deprived of any of the important attributes of ownership, such as the 'right to decide which stock he is going to sell.'* Indeed it is conceded, at least by the taxpayer in this case, that the regulation, as we now interpret it, 'provides a useful and reasonable rule for ascertaining what stock was sold in cases where there is no proof, or lack of satisfactory proof, of the fact.' " (Italics supplied)

In the instant case it has been stipulated by the parties that such identification between the certificates surrendered and the certificates received exists. Accordingly, under the additional argument presented under this point *E*,

even though the Petitioner be mistaken in the position urged under points *B* and *C*, above, nevertheless, in view of such identification, the basis to the Petitioner of the Dow common stock sold must be held to be the same as the basis of the identical Great Western stock for which it was exchanged.

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**CONCLUSION**

In view of the foregoing, it is respectfully submitted that the decision of the Tax Court should be reversed.

Respectfully submitted,

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